COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

JOINT APPLICATION OF LOUISVILLE GAS AND ELECTRIC COMPANY AND KENTUCKY UTILITIES COMPANY FOR APPROVAL OF MERGER	) CASE NO. 97-300

ORDER

IT IS ORDERED that Louisville Gas and Electric Company ("LG&E") and Kentucky Utilities Company ("KU") shall file the original and 10 copies of the following information with the Commission no later than August 11, 1997, with a copy to all parties of record. Each copy of the data requested should be placed in a bound volume with each item tabbed. When a number of sheets are required for an item, each sheet should be appropriately indexed, for example, Item 1(a), Sheet 2 of 6. Include with each response the name of the witness who will be responsible for responding to questions relating to the information provided. Careful attention should be given to copied material to ensure that it is legible.

1. Refer to the response to the Commission's July 24, 1997 Order, Item 1. Explain why KU Energy Corporation ("KU Energy") is not required to file a Securities and Exchange Commission Form U-3A-2.

2. Refer to the responses to the Commission's July 24, 1997 Order, Item 2.

a. In Item 2(d), KU was ordered to provide a balance sheet on a total company basis which showed Kentucky jurisdictional and other jurisdictional operations separately. KU did not comply with the Order in that it only provided a balance sheet on a total company basis without the jurisdictional separations. The response stated, "The complete Balance Sheet is not separated on a jurisdictional basis." Provide the originally requested jurisdictional information.

b. In Item 2(e), LG&E was ordered to provide a Kentucky jurisdictional balance sheet separating the electric and gas operations. LG&E did not comply with the Order, stating that, "The complete balance sheet is not maintained on an electric and gas basis." Provide the originally requested operational information.

3. On page 7 of his testimony, Mr. Hale states that, "The new competitive environment is almost upon us, making the control of costs and the attainment of economies of scale today critical to a firm's success tomorrow."

a. Describe the "new competitive environment" referred to here.

b. Does Mr. Hale expect retail access or competition to become a reality in Kentucky? If so, when?

c. Describe how retail access or competition in Kentucky will affect the merged companies.

d. Has LG&E taken a position on retail electric competition? If so, describe LG&E's position.

e. What will be the position or policy of the merged company regarding retail electric competition in Kentucky?

4. On page 5 of Mr. Whitley's testimony he states, "By combining, we are creating a larger, financially stronger combined company that is better positioned to meet the inevitable competition that will come from other non-Kentucky entities."

a. Describe the competition that Mr. Whitley considers inevitable.

b. Has KU taken a position on retail competition in Kentucky? If so, describe KU's position.

c. Before agreeing to merge with LG&E, did KU consider whether its position on retail electric competition, if any, was consistent with any position taken by LG&E regarding retail competition? What was the result of any consideration on this matter?

5. In response to Item 57 of the First Data Request of POWER and MHNA, Mr. Staffieri states that neither LG&E nor KU has a formal study that supports the testimony of Dr. Haywood cited in the question. This question referred to any studies "prepared or commissioned" concerning future competition resulting from the deregulation of the retail power market.

a. Is it true that LG&E or KU in conjunction with other electric utilities have commissioned the University of Kentucky to conduct a study of electric industry competition or deregulation?

b. If so, describe the purpose, scope and current status of the study.

c. If such a study is underway, describe the extent of participation by Dr. Haywood in the study.

6. Refer to the testimony of A. Joseph Van den Berg.

a. Provide a description of the processes involved with the Synergies Analysis performed for KU Energy and LG&E Energy.

b. Provide a listing describing all assumptions and limiting parameters employed in the Synergies Analysis. Identify whether the assumption or parameter was developed by KU Energy personnel, LG&E Energy personnel, Deloitte Consulting, or already existed in models used in the Synergies Analysis.

7. Refer to the Van den Berg testimony, pages 3 and 4. Mr. Van den Berg identifies 20 "publicly announced transactions" in which Deloitte Consulting has been involved.

a. Indicate how many of the 20 transactions have actually occurred and how many are still pending.

b. For those transactions which have actually occurred, indicate how accurate the analysis of Deloitte Consulting was in estimating merger or acquisition savings and the costs of those savings.

8. With reference to Mr. Van den Berg's testimony and Exhibit AJV-3. Explain what procedures were followed to determine that the identified savings from labor reductions and other savings were most appropriate and not just simple conservative estimates.

9. Regarding the decision to exclude consideration of "enabled" and "developed" savings from the determination of the savings that can be achieved, explain how the labor reductions for each functional area were developed.

10. Refer to Exhibit AJV-1. This exhibit shows that potential savings are expected to be achieved in increasing amounts through 2008. Considering that almost 60 percent of the total gross savings are achieved between 2004 and 2008, explain why it would not be appropriate to amortize the cost to achieve the savings over 10 years rather than the proposed 5 years.

11. Refer to the response to the Commission's July 24, 1997 Order, Item 10(c) and the response to the Kentucky Industrial Utility Customers' ("KIUC") First Set of Data Requests, Item 1, Attachment. The back up information provided in the Attachment to KIUC Item 1 includes an analysis of information system needs for KU Energy and LG&E Energy. Most of this analysis was completed by the end of 1996. In June 1997 LG&E Energy selected the Oracle Corporation to provide the software for a significant upgrade of its information systems.

a. If the merger takes place as planned, will the Oracle Corporation software be installed on KU's information system to integrate the respective financial systems? If no, explain why not.

b. Would the utilization of the Oracle Corporation's software tend to increase, decrease, or not affect the estimated savings identified for information systems? Explain the response.

12. Refer to the response to the Commission's July 24, 1997 Order, Item 11. In this response, Dr. Haywood states, "There is nothing in [my] testimony that implies or relies in any way on an assumption that the retail electric market will be deregulated." Reconcile this statement with <u>each</u> of the following passages from Dr. Haywood's testimony in which he explicitly bases his merger evaluations and recommendations on the assumption of a competitive retail electric market.

> a. My recommendation is that the PSC should not mandate a reduction or series of reductions in rates. . . . In the new competitive environment for utilities, competitive forces should be allowed to work their effects on the allocation of the estimated cost savings.[1]

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[1] Haywood Testimony, at 17, beginning at line 6.

b. I quarrel with such regulatory approach because it interferes with the competitive decision making that deregulation is intended to free up to see if enduring reductions in social and private costs can be achieved by management.[2]

c. What I am advocating is that PSCs should give competition a chance to work without skewing the results in one direction or the other.[3]

d. As I have said, I think that use of a "toll gate" approach by regulatory agencies in approving mergers is contrary to the purpose of the deregulation now taking place in the industry. It interferes with the competitive decision making that deregulation is intended to free up to see if enduring reductions in social and private costs can be achieved by management. PSCs should give competition a chance to work without skewing the results in one direction or the other. . . . In the proposed merger of LG&E and KU the five-year commitment not to seek an increase in base rates provides a safety net for consumers. Management should be given the opportunity to allocate cost savings to optimize competitive advantages. If management starts to veer away from the competitive optimum, two forces will exert corrective influences. One will, of course, be the Kentucky PSC; the other force will be the competitive marketplace itself. I think that the Kentucky PSC and other regulatory agencies should not seek to mandate the results but should take a wait and see approach to allow deregulation, competition, and structural change an opportunity to increase efficiency, lower costs, and decrease rates while also improving returns to shareholders.[4]

13. In his testimony, Dr. Haywood states "Management should be given an opportunity to allocate cost savings to optimize competitive advantages."

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2 Id., at 18, beginning at line 24.

3 Id., at 19, beginning at line 6.

4 Id., at 28, beginning at line 11.

a. Was Dr. Haywood aware that LG&E and KU have proposed to allocate the anticipated cost savings from the merger on a 50-50 basis between the two companies?

b. Is this proposed allocation between companies in conflict with Dr. Haywood's statement? Explain the response.

14. Refer to page 17, lines 16 through 18, of Dr. Haywood's testimony.

a. Describe the "new competitive environment for utilities" to which Dr. Haywood refers.

b. Define the "competitive forces" to which Dr. Haywood refers.

15. Refer to Dr. Haywood's discussion on "toll gate" decision making on pages 18, line 15, through page 19, line 15.

a. Dr. Haywood states that this regulatory approach interferes with "the competitive decision making that deregulation is intended to free up." Describe the competitive decision making to which Dr. Haywood refers.

b. Dr. Haywood also states that Public Service Commissions should give competition a chance to work. In the context of this proceeding, describe the competition to which Dr. Haywood refers.

16. With regard to Dr. Haywood's several references to competition and to deregulation, describe what impact the Commission's decision in this case will have on any industry movement toward competition or deregulation.

17. In his testimony, Dr. Haywood refers to and relies on the testimony of Dr. Robert M. Spann for submittal in the LG&E/KU merger application to the Federal Energy Regulatory Commission ("FERC").

a. Provide a copy of all drafts of testimony, exhibits, analysis, memoranda, notes or correspondence prepared by or for Dr. Spann and made available to Dr. Haywood.

b. Provide a complete copy of Dr. Spann's FERC testimony, including all exhibits, calculations, assumptions, and analyses.

18. On page 8 of his testimony, Dr. Haywood refers to wholesale and retail electric power markets. Describe the factors or characteristics that distinguish these two power markets.

19. On page 10 of his testimony, Dr. Haywood states, "Further, the wholesale market is the only 'window to the future' we have at present with respect to what may develop in the retail market when and if it is deregulated."

a. Describe the present competitive nature of both the national and statewide wholesale electric power markets.

b. Explain generally how a competitive wholesale electric power market relates to or is relevant to a retail electric power market.

c. Describe the nature and characteristics of a "deregulated" retail power market as Dr. Haywood understands it.

20. On page 20 of his testimony, Dr. Haywood discusses enhanced economic development in the combined service areas of LG&E and KU resulting from the merger.

Specifically, he implies that the low-cost competitive position of the merged companies will attract industries to locate in their service areas. If retail access or competition becomes a reality and, as a result, out-of-state industries are able to directly purchase low-cost electricity produced by LG&E or KU without a physical presence in Kentucky, what enticements or incentives would there be for these industries to locate in Kentucky? Would economic development efforts in Kentucky, either by the merged companies or state government, be hampered or stymied by such an open-access scenario?

21. On page 32 of Dr. Haywood's testimony he states that, "Sometimes, however, changes in regulation may cause changes in output mix, input mix, and/or industry structure, such as we are seeing today in the electric utilities industry." Describe what it is that "we are seeing today." Describe what is meant by "changes in regulation."

22. Refer to the response to the Commission's July 24, 1997 Order, Item 14, Attachment 2, page 4 of 4. The weighted average cost of capital shown on this page reflects a rate of return on common equity of 11 percent. Explain how KU and LG&E determined that the rate of 11 percent was reasonable. Include all workpapers, studies, or other analyses used to determine the 11 percent rate.

23. Refer to the response to the Commission's July 24, 1997 Order, Item 16. If KU, KU Energy, LG&E, or LG&E Energy were to experience either enabled or developed savings from the proposed merger, identify who would receive these savings.

24. Refer to the response to the Commission's July 24, 1997 Order, Item 17(b). The answer was not responsive to the information requested. Item 17(b) stated "If the

cash flow approach was used for the other cost savings, what would have been the level of cost savings if the revenue requirements approach had been used for all cost savings analyses?" Provide the originally requested information, including any workpapers and calculations used to determine the estimate.

25. Refer to the response to the Commission's July 24, 1997 Order, Item 18. Describe the additional analysis that LG&E and KU have determined should be performed prior to making the merger filing before the FERC.

26. Refer to the response to the Commission's July 24, 1997 Order, Item 18, Application before the Virginia State Corporation Commission ("Virginia Commission"), Exhibit F. Exhibit F is identified as a "Services Agreement."

a. Describe the purpose of this agreement.

b. Explain why such an agreement was part of the application filed with the Virginia Commission, but no corresponding document was filed in the application in this proceeding.

c. Does LG&E Energy plan to create a service corporation subsidiary as a result of the proposed merger?

27. Refer to the response to the Commission's July 24, 1997 Order, Item 26. The response indicates that a significant portion of the coal purchases are related to transactions with a term of more than three years. Given the length of the term on these coal purchase transactions, would it be correct that customers of LG&E and KU will not receive the majority of fuel-related savings until two or three years after the completion of the merger? If no, explain why not.

28. Refer to the response to the Commission's July 24, 1997 Order, Item 27. Using the same time periods for comparison, provide an analysis showing the KW and KWH sales to the three customer classes for LG&E and KU.

29. Refer to the response to KIUC's First Set of Data Requests, Item 15, Transmission Coordination Agreement, page 18 of 19. Provide the calculations and workpapers used to determine the allocation ratios shown on this page.

30. In KU's and LG&E's last general rate cases, the subject of membership dues paid to the Electric Power Research Institute ("EPRI") was an issue.

a. Describe KU's and LG&E's relationship with EPRI as of June 30, 1997.

b. Provide the amount of the most recent membership dues for each utility.

c. What changes, if any, are expected to occur with respect to EPRI membership if the proposed merger does take place?

d. Describe KU's and LG&E's current research and development activities.

e. What changes, if any, are expected to occur with respect to research and development activities if the proposed merger does take place?

31. Refer to Mr. Willhite's testimony regarding the 50/50 sharing, Exhibit AJV-1, and Appendix N.

a. What percentage is the customers' share of non-fuel merger savings (Appendix N, line 3) of the total gross savings (Exhibit AJV-1)?

b. What percentage of the potential net savings is not currently addressed by the surcredit proposed in this case?

32. In response to Item 18 of the Commission's Order dated July 27, 1997, Mr. Willhite explains that additional analysis is being performed on Dr. Spann's regional market power analysis. Explain the nature of this additional analysis. Provide a final or draft copy of this additional analysis no later than close of business on Wednesday, August 13, 1997.

33. Refer to the response to POWER's and MHNA's first data request, Item 62.

a. Does Mr. Hale understand the question set forth therein?

b. Explain why Mr. Staffieri was named as the witness responsible for responding to a question that relates to Mr. Hale's direct testimony.

Done at Frankfort, Kentucky, this 6th day of August, 1997.

PUBLIC SERVICE COMMISSION

Linda K Breathitt

For the Commission

ATTEST:

Don Mills

Executive Director